AFFILIATED COMPUTER SERVICES INC
Form 10-Q
February 14, 2001

1

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2000

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the period from __________ to __________

Commission file number 0-24787

AFFILIATED COMPUTER SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware	51-0310342
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2828 North Haskell, Dallas, Texas	75204
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (214) 841-6111

Not Applicable

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

TITLE OF EACH CLASS	NUMBER OF SHARES OUTSTANDING AS OF FEBRUARY 12, 2000

Class A Common Stock, $.01 par value	46,659,526
Class B Common Stock, $.01 par value	3,299,686

	49,959,212

2

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES

INDEX

3

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	DECEMBER 31,	JUNE 30,

		2000 (UNAUDITED)		2000 (AUDITED)
ASSETS				
Current assets:				
Cash and cash equivalents	$	14,234	$	44,521
Accounts receivable, net		417,360		399,853
Receivable from divestitures		--		180,335
Inventory		8,980		7,324
Prepaid expenses and other current assets		74,023		71,290
Net assets held for sale		--		43,362
Deferred taxes		15,965		25,189
Total current assets		530,562		771,874
Property, equipment and software, net		222,688		194,034
Goodwill and other intangibles, net		731,301		650,263
Long-term investments and other assets		41,785		40,275
Total assets	$	1,526,336	$	1,656,446
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	27,284	$	47,901
Accrued compensation and benefits		57,638		69,208
Other accrued liabilities		145,459		156,720
Income taxes payable		9,165		60,671
Short-term debt		2,002		2,877
Current portion of unearned revenue		19,628		20,865
Total current liabilities		261,176		358,242
Convertible notes due 2005		230,000		230,000
Long-term debt		178,101		295,619
Deferred taxes		41,999		35,316
Other long-term liabilities		23,808		25,892
Total liabilities		735,084		945,069
Stockholders' equity:				
Class A common stock		467		463
Class B common stock		33		33
Additional paid-in capital		327,283		321,525
Retained earnings		462,714		400,200
Accumulated other comprehensive income (net of tax)		776		--
Treasury stock		(21)		(10,844
Total stockholders' equity		791,252		711,377
Total liabilities and stockholders' equity	$	1,526,336	$	1,656,446

See notes to consolidated financial statements.

1

4

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended December 31,		Six Months E[nded] December 3[1,]	
	2000	1999	2000	
Revenues	$ 500,882	$ 476,008	$ 979,508	$
Expenses:				
Wages and benefits	212,442	203,383	428,631	
Services and supplies	151,477	150,594	280,982	
Rent, lease and maintenance	52,683	50,672	115,389	
Depreciation and amortization	22,576	21,169	43,668	
Other operating expenses	4,977	4,780	11,938	
Total operating expenses	444,155	430,598	880,608	
Operating income	56,727	45,410	98,900	
Interest expense	4,839	5,631	9,875	
Other non-operating income, net	(991)	(4,593)	(14,358)	
Pretax profit	52,879	44,372	103,383	
Income tax expense	20,887	17,926	40,836	
Net income	$ 31,992	$ 26,446	$ 62,547	$
Earnings per common share:				
Basic	$ .64	$ .54	$ 1.26	$
Diluted	$ .59	$ .50	$ 1.16	$
Shares used in computing earnings per common share:				
Basic	49,811	49,319	49,625	
Diluted	56,881	55,866	56,545	

See notes to consolidated financial statements.

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	SIX MO DECE 2000
Cash flows from operating activities:	
Net income	$ 62,547
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Depreciation and amortization	43,668
Gain on sale of investment	(12,785
Gain on collection of note receivable	(1,713
Other	386
Changes in assets and liabilities, net of effects from acquisitions:	
Increase in ATM cash	--
(Increase) decrease in accounts receivable	(13,687
Increase in inventory	(1,549
Increase in prepaid expenses and other current assets	(6,503
Change in deferred taxes	16,098
Increase in other long-term assets	(585
Decrease in accounts payable	(22,826
Decrease in accrued compensation and benefits	(11,215
Increase in other accrued liabilities	4,215
Increase (decrease) in income taxes payable	(43,564
Decrease in unearned revenue	(5,163
Increase (decrease) in other long-term liabilities	98
Total adjustments	(55,125
Net cash provided by operating activities	7,422
Cash flows from investing activities:	
Purchases of property, equipment and software, net of sales	(51,679
Payments for acquisitions, net of cash acquired	(86,264
Proceeds from divestitures, net of transaction costs	208,428
Purchase of investments	(2,138
Proceeds from sale of investment	17,100

Additions to other intangible assets	(13,794
Additions to notes receivable	(819
Proceeds received on notes receivable	7,898
Other	--
Net cash provided by (used in) investing activities	78,732
Cash flows from financing activities:	
Proceeds from issuance of debt, net of issuance costs	229,422
Repayments of debt	(352,324
Proceeds from stock options exercised	6,756
Net repayment of ATM debt	--
Other, net	(295
Net cash provided by (used in) financing activities	(116,441
Net decrease in cash and cash equivalents	(30,287
Cash and cash equivalents at beginning of period	44,521
Cash and cash equivalents at end of period	$ 14,234

See notes to consolidated financial statements.

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Affiliated Computer Services, Inc. and its majority-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated. We are a Fortune 1000 Company based in Dallas, Texas with operations primarily in North America, as well as Central America, South America, Europe and the Middle East. We provide a full range of information technology services, including technology outsourcing, business process outsourcing and systems integration.

The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2000. The foregoing unaudited consolidated financial statements reflect all adjustments (all of which are of a normal recurring nature) which are, in the opinion of management, necessary for a fair presentation of the results of the interim periods. The results for the interim periods are not necessarily indicative of results to be expected for the year. Certain financial statement items from the prior year have been reclassified to conform with current presentation.

2. HEDGING ACTIVITIES AND COMPREHENSIVE INCOME

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivatives and Hedging Activities". The statement requires us to record all derivatives on the balance sheet at fair value. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivatives are either recognized in earnings or are recognized in other comprehensive income until the hedged item is recognized in earnings. As of December 31, 2000, the fair market value of our interest rate hedge was $1.3 million and was recorded in other current assets.

Statement of Financial Accounting Standards No. 130 "Reporting Comprehensive Income" establishes standards for reporting and display of comprehensive income and its components in the financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income is the total of net income and all other non-owner changes within a company's equity.

The components of comprehensive income are as follows (in the thousands):

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2000	1999	2000	1999
Net income	$ 31,992	$ 26,446	$ 62,547	$ 51,47
Change in fair value of derivatives (net of tax effect of ($460) and $507, respectively)	(703)	--	776	-
Comprehensive income	$ 31,289	$ 26,446	$ 63,323	$ 51,47

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

3. EARNINGS PER SHARE

In accordance with Statement of Financial Accounting Standard No. 128, "Earnings per Share", the following table (in thousands, except per share amounts) sets forth the computation of basic and diluted earnings per share:

	THREE MONTHS ENDED DECEMBER 31, 2000	1999	20
Numerator:			
Numerator for earnings per share (basic) - Income available to common stockholders	$ 31,992	$ 26,446	$
Effect of dilutive securities:			
Interest on 4% convertible debt	1,540	1,538	
Numerator for earnings per share assuming Dilution - income available to common stockholders	$ 33,532	$ 27,984	$
Denominator:			
Weighted average shares outstanding (basic)	49,811	49,319	
Effect of dilutive securities:			
4% convertible debt	5,392	5,392	
Stock options	1,678	1,155	
Total potential common shares	7,070	6,547	
Denominator for earnings per share assuming Dilution	56,881	55,866	
Earnings per common share (basic)	$ .64	$ .54	$
Earnings per common share assuming dilution	$ .59	$ .50	$

4. NON-RECURRING ITEMS

In the first quarter of fiscal 2001, we recorded a $12.8 million gain in other non-operating income related to the sale of a non-strategic minority investment in ACS Merchant Services, Inc. Also during the quarter, we recorded a $10.4 million charge in connection with the termination of certain hardware leases and disaster recovery contracts (reflected in rent, lease and maintenance expense) and a $2.1 million charge for non-recurring litigation costs and the writedown of property held-for-sale (reflected in other operating expense).

In the second quarter of fiscal 2000, we recorded $3.0 million of accelerated expenses in connection with the consolidation of certain business process outsourcing operations. These expenses include approximately $2.6 million related to duplicate software and production facilities (reflected in rent, lease and maintenance expense), $0.2 million of unamortized leasehold improvements and write offs of excess equipment (reflected in depreciation and amortization expense) and $0.2 million for severance payments for reductions in staff (reflected in wages and benefits expense).

In January 1999, we sold a business unit of an acquired company to CyberPlus Corporation ("Cyberplus"). As part of the consideration, we received a $3.2 million promissory note due March 2000 and 2.1 million warrants to purchase CyberPlus common stock. Given the financial uncertainty surrounding CyberPlus, the note receivable was fully reserved. In November 1999, CyberPlus obtained financing and repaid $3.0 million on the promissory note, resulting in a $3.0 million gain (reflected in other non-operating income).

5. ACCUMULATED DEPRECIATION AND AMORTIZATION

Property, equipment and software are stated net of accumulated depreciation of $186.2 million and $165.6 million at December 31, 2000 and June 30, 2000, respectively. Additionally, goodwill and other intangibles are stated net of accumulated amortization of $96.6 million and $80.3 million at December 31, 2000 and June 30, 2000, respectively.

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

6. ACQUISITIONS

During December 2000, we acquired Business Resources Corporation, ("BRC"), a subsidiary of Tyler Technologies, Inc. for approximately $70 million in cash, which was funded by our existing credit facility. The acquisition was accounted for under the purchase method of accounting with assets acquired of $76.2 million and liabilities assumed of $6.2 million. BRC's results have been included in our consolidated financial statements from the effective date of the acquisition. BRC is a provider of outsourced records management, document workflow, imaging systems and services to state and local governments. BRC also provides real estate title plant services to title companies.

7. SEGMENT INFORMATION

Based on the criteria set forth in Statement of Financial Accounting Standard No. 131, "Disclosure about Segments of an Enterprise and Related Information," we have two reportable segments: commercial and federal government. Certain reclassifications have been made to the segment disclosure as the result of changes to our reporting structure. Prior year results have been restated for comparison purposes. The following is a summary of certain financial information by reportable segment (in thousands):

QUARTER ENDED DECEMBER 31, 2000

	COMMERCIAL	FEDERAL GOVERNMENT	CORPORATE	CO
Revenue	$ 314,728(a)	$ 186,154	$ --	$
Operating expense	249,468	168,000	4,111	
EBITDA(c)	65,260	18,154	(4,111)	
Depreciation & amortization expense excluding goodwill amortization	13,419	2,751	392	

Goodwill amortization	4,857	1,157	--	--
Operating income (loss)	$ 46,984	$ 14,246	($ 4,503)	$

QUARTER ENDED DECEMBER 31, 1999

	COMMERCIAL	FEDERAL GOVERNMENT	CORPORATE	CO
Revenue	$ 323,142(a)	$ 152,866	$ --	$
Operating expense	268,165(d)	138,617	2,647	
EBITDA(c)	54,977	14,249	(2,647)	
Depreciation & amortization expense excluding goodwill amortization	13,315	2,280	282	
Goodwill amortization	4,675	617	--	
Operating income (loss)	$ 36,987	$ 11,352	($ 2,929)	$

(a) Revenue includes $0 and $74.6 million for the three months ended December 2000 and 1999, respectively, and $7.5 million and $154.3 million for the six months ended December 31, 2000 and 1999, related to the divestitures announced in June 2000.

(b) Operating expense includes $12.5 million of non-recurring charges related to hardware lease buyouts and disaster recovery contracts, legal fees and a writedown of property held-for-sale to market value (see Note 4).

(c) EBITDA consist of earnings before interest income, interest expense, other non-operating income and expense, income taxes, depreciation and amortization. EBITDA is not a measure of financial performance under generally accepted accounting principles and should not be considered in isolation or as an alternative to net income as an indicator of a company's performance or to cash flows from operating activities as a measure of liquidity.

(d) Operating expense for quarter ended December 31, 1999 included $3.0 million of accelerated expenses in connection with the consolidation of certain business process outsourcing operations (see Note 4).

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

7. SEGMENT INFORMATION (CONTINUED)

SIX MONTHS ENDED DECEMBER 31, 2000

	COMMERCIAL	FEDERAL GOVERNMENT	CORPORATE	C
Revenue	$ 615,744(a)	$ 363,764	$ --	$
Operating expense	500,974(b)	328,418	7,548	
EBITDA(c)	114,770	35,346	(7,548)	
Depreciation & amortization expense excluding goodwill amortization	25,672	5,482	713	
Goodwill amortization	9,486	2,315	--	
Operating income (loss)	$ 79,612	$ 27,549	($ 8,261)	$

SIX MONTHS ENDED DECEMBER 31, 1999

	COMMERCIAL	FEDERAL GOVERNMENT	CORPORATE	CO
Revenue	$ 630,383(a)	$ 293,311	$ --	$
Operating expense	520,984(d)	265,534	5,530	
EBITDA(c)	109,399	27,777	(5,530)	
Depreciation & amortization expense excluding goodwill amortization	25,587	4,316	544	
Goodwill amortization	8,914	1,198	--	
Operating income (loss)	$ 74,898	$ 22,263	($ 6,074)	$

(a) Revenue includes $0 and $74.6 million for the three months ended December 2000 and 1999, respectively, and $7.5 million and $154.3 million for the six months ended December 31, 2000 and 1999, related to the divestitures announced in June 2000.

(b) Operating expense includes $12.5 million of non-recurring charges related to hardware lease buyouts and disaster recovery contracts, legal fees and a writedown of property held-for-sale to market value (see Note

4).

(c) EBITDA consist of earnings before interest income, interest expense, other non-operating income and expense, income taxes, depreciation and amortization. EBITDA is not a measure of financial performance under generally accepted accounting principles and should not be considered in isolation or as an alternative to net income as an indicator of a company's performance or to cash flows from operating activities as a measure of liquidity.

(d) Operating expense for quarter ended December 31, 1999 included $3.0 million of accelerated expenses in connection with the consolidation of certain business process outsourcing operations (see Note 4).

7

10

AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included in this MD&A regarding our financial position, business strategy and plans and objectives of our management for future operations are forward-looking statements. These forward-looking statements rely on a number of assumptions concerning future events and are subject to a number of uncertainties and other factors, many of which are outside of our control, that could cause actual results to materially differ from such statements. While we believe that the assumptions concerning future events are reasonable, we caution that there are inherent difficulties in predicting certain important factors, especially the timing and magnitude of technological advances; the performance of recently acquired businesses; the prospects for future acquisitions; the possibility that a current customer could be acquired or otherwise be affected by a future event that would diminish its information technology requirements; the competition in the information technology industry and the impact of such competition on pricing, revenues and margins; the degree to which business entities continue to outsource information technology and business processes; uncertainties surrounding budget reductions or changes in funding priorities or existing government programs; and our ability, and the related cost of attracting and retaining highly skilled personnel.

SIGNIFICANT DEVELOPMENTS

During the fourth quarter of fiscal 2000, we entered into a formal plan to divest certain business units consisting of our ATM processing business and our commercial staffing business due to the fact that these businesses were no longer strategic to our long-term goal of providing information technology and business process outsourcing services. By October 31, 2000, we had completed the sale of and received the proceeds from these divestitures. During the first quarter of fiscal 2001, we recorded a $12.8 million gain in other non-operating income associated with the sale of a non-strategic minority investment in ACS Merchant Services, Inc.

RESULTS OF OPERATIONS

The following table sets forth certain items from our consolidated statements of income as a percentage of revenues:

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS E DECEMBER 3
	2000	1999	2000
Revenues	100%	100%	100%
Expenses:			
Wages and benefits	42.4	42.7	43.8
Services and supplies	30.3	31.6	28.7
Rent, lease and maintenance	10.5	10.7	11.8
Depreciation and amortization	4.5	4.5	4.5
Other operating expenses	1.0	1.0	1.1
Total operating expenses	88.7	90.5	89.9
Operating income	11.3	9.5	10.1
Interest expense	1.0	1.2	1.0
Other non-operating income, net	(0.2)	(1.0)	(1.5)
Pretax profit	10.5	9.3	10.6
Income tax expense	4.1	3.8	4.2
Net income	6.4%	5.5%	6.4%

COMPARISON OF THE QUARTER ENDED DECEMBER 31, 2000 TO THE QUARTER ENDED DECEMBER 31, 1999

The divested units contributed $74.6 million in revenue in the second quarter of fiscal 2000. Excluding the divested units, revenues increased 25% from $401.4 million to $500.9 million for the second quarter of fiscal 2001. More than half of the increase, or 14%, was derived from internal growth. Excluding the revenues from the divested units, revenues from our commercial segment increased $66.2 million, or 27%. Revenue growth in the commercial segment was primarily due to new signings in state Medicaid and welfare benefit program management, as well as information technology contract signings. Revenues from our federal government segment increased $33.3 million, or 22%, over the prior year quarter primarily due to the acquisition of Intellisource in the fourth quarter of fiscal 2000.

Included in the operating expenses in the second quarter of fiscal 2000 was $3.0 million of accelerated expenses related to the consolidation of certain business process outsourcing operations (see Note 4). Excluding this non-recurring charge, operating margins increased 1.1% from 10.2% to 11.3% as a result of the divestiture program completed in the first quarter. Services and supplies decreased as a percentage of revenue from 31.6% to 30.3% due to the divestiture of the ATM processing business, which had a large component of interchange fees paid to ATM distributors.

Other non-operating income for the second quarter of fiscal 2000 included the recognition of a $3.0 million gain on the collection of a fully reserved note receivable from the sale of a business unit in fiscal 1999 (see Note 4). Excluding this non-recurring gain, other non-operating income decreased by $0.6 million.

Our effective tax rate of approximately 39.5% in the second quarter of fiscal 2001 exceeded the federal statutory rate of 35%, due primarily to the amortization of certain acquisition-related costs that are non-deductible for tax purposes, plus the net effect of state income taxes.

COMPARISON OF THE SIX MONTHS ENDED DECEMBER 31, 2000 TO THE SIX MONTHS ENDED DECEMBER 31, 1999

Excluding revenues related to the divested units ($7.5 million and $154.3 million for the six months ended December 31, 2000 and 1999 respectively), revenue increased $202.6 million, or 26% over the prior year from $769.4 million to $972.0 million. Revenues from our commercial segment increased, excluding the divested units, $132.1 million, or 28%, due to acquisitions as well as signings of new customer contracts in state Medicaid and Welfare benefit program management and information technology. Revenues in our federal government segment increased $70.5 million, or 24%, primarily as a result of the acquisition of Intellisource in the fourth quarter of fiscal year 2000.

Excluding the $12.5 million and $3.0 million in non-recurring charges in the first six months of fiscal years 2001 and 2000, respectively (see Note 4), operating margins increased 1.2% from 10.2% to 11.4% in fiscal 2001 as a result of the completed divestiture program announced in the fourth quarter of fiscal 2000. Wages and benefits as a percentage of revenue increased from 43.1% to 43.8% as a result of the divestitures, which had a smaller component of wages and benefit expense, and our continued focus on delivering business process outsourcing services, which has a larger component of wages and benefits. Services and supplies as a percentage of revenue decreased from 30.7% to 28.7% as a result of the divestiture of the ATM processing business, which had a large component of interchange fees paid to ATM distributors. After adjusting for the non-recurring charges of $10.4 million in fiscal 2001 and $2.6 million in fiscal 2000, rent, lease and maintenance expense remained relatively constant.

Other non-operating income includes non-recurring gains of $12.8 million and $3.0 million in the six months ended December 31, 2000 and 1999, respectively (see Note 4). Excluding these gains, other non-operating income decreased as a percentage of revenue from 0.3% to 0.2%.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2000, we had cash and cash equivalents totaling $14.2 million compared to $44.5 million at June 30, 2000. Included in the cash balances at December 31, 2000 and June 30, 2000 were $12.8 million and $22.3 million, respectively, of restricted cash held on behalf of governmental customers. Working capital decreased to $269.4 million at December 31, 2000 from $413.6 million at June 30, 2000 due primarily to the collection of proceeds from divestitures and the subsequent paydown of long-term debt.

Cash flow from operations was $7.4 million for the six months ended December 31, 2000. However, during the first quarter of fiscal 2001, we paid approximately $48.7 million in income taxes related to the net gain from our divestiture activity and approximately $10.4 million of non-recurring lease termination charges, which are included in cash flows from operations. After adjusting for these items, our net cash provided by operating activities would have been approximately $66.5 million for the six months ended December 31, 2000. Cash flow from investing activities was $78.7 million primarily due to the collection of proceeds from divestitures offset by the acquisition of BRC in the second quarter of fiscal 2001. Net cash used in financing activities was $116.4 million, which was the result of credit facility paydowns from the divestiture proceeds less the borrowing for the BRC acquisition.

In order to manage interest costs and exposure to changing interest rates, we hold two interest rate hedges initiated in December 1998 and expiring in December 2001. Each hedge is structured such that we pay a fixed rate of interest of 4.54% and receive a floating rate of interest based on one month LIBOR. The notional amount of the two hedges totals $100,000,000 and the fair market value of the two hedges at December 31, 2000 was approximately $1.3 million, which is recorded in other current assets (see Note 2). The fair value of each interest rate hedge reflects termination cash value.

Management believes that available cash and cash equivalents, together with cash generated from operations and available borrowings under our credit facility, will provide adequate funds for our anticipated internal growth needs, including working capital expenditures. Our management also believes that cash provided by operations will be sufficient to satisfy all existing debt obligations as they become due. However, we intend to continue our growth through acquisitions and we regularly evaluate potential acquisition candidates, which acquisitions could require significant commitments of capital. In order to pursue such opportunities, we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and expansion opportunities and how such opportunities will be financed.

NEW ACCOUNTING STANDARDS

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements". SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements and required adoption no later than the fourth quarter of fiscal 2001. We do not believe the adoption of SAB 101 will have a material impact on our future earnings and financial position.

PART II

ITEM 1. LEGAL PROCEEDINGS

On December 16, 1998, a state district court in Houston, Texas entered final judgment against us in a lawsuit brought by twenty-one former employees of Gibraltar Savings Association and/or First Texas Savings Association (collectively, "GSA/FTSA"). The GSA/FTSA employees alleged that they were entitled to the value of 401,541 shares of our stock pursuant to options issued to the GSA/FTSA employees in 1988 in connection with a former data processing services agreement between GSA/FTSA and us. The judgment against us was for approximately $17,000,000, which includes attorneys' fees and pre-judgment interest, but excludes additional attorneys' fees of approximately $850,000 which could be awarded in the event the plaintiffs are successful upon appeal and final judgment. We continue to believe that we have a meritorious defense to all or a substantial portion of the plaintiffs' claims. We filed our appeal of the judgment on March 15, 1999 and are vigorously pursuing the appeal. The plaintiffs also filed a notice of appeal and are pursuing their appeal. Should the proceedings not be favorably resolved on appeal, we would be subject to a charge equal to the amount of any final judgment, fees and interest awarded in favor of the plaintiffs.

Government contracts are subject to review and audit by various governmental authorities in the normal course of our business. Cost audits have been completed through fiscal 1998 for a majority of the federal government business operations. In management's opinion, any such reviews and the results of cost audits for subsequent fiscal years will not have a material effect on our financial position or results of operations.

We are subject to certain other legal proceedings, claims and disputes which arise in the ordinary course of business. Although we cannot predict the outcomes of these legal proceedings, management does not believe these actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On October 26, 2000, we held our 2000 annual meeting of stockholders, at which meeting our stockholders were asked to vote on the following proposals: (i) elect two directors to the Board ("Proposal 1") and (ii) approve the performance-based incentive compensation for our executive officers ("Proposal 2"). The results of the votes on such proposals were as follows:

Proposal 1:	Votes	
	For	Withheld
Darwin Deason	68,325,867	7,179,368
Jeffrey A. Rich	74,584,312	920,923

	Votes For	Votes Against	Abstentions
Proposal 2:	74,580,693	760,703	163,839

The following individuals continued their respective terms of service as directors of Affiliated Computer Services, Inc. following the meeting:

Mark A. King
William L. Deckelman, Jr.
Peter A. Bracken

Henry Hortenstine
Joseph P. O'Neill
Frank A. Rossi
Clifford M. Kendall

ITEM 5. OTHER INFORMATION

On February 14, 2001, we filed a Certificate of Correction of our Second Amended and Restated Certificate of Incorporation to remove a provision establishing a classified Board of Directors. The provision had been the subject of a vote at a stockholders meeting held on December 16, 1997, after which the amendment was filed with the Delaware Secretary of State. While the proposed amendment received the approval of more than 80% of the voting shares present and voting on the measure, it failed to receive the required approval of 80% of our total outstanding voting stock. We filed the Certificate of Correction promptly upon determining that the required approval was not obtained. Our current directors, who with one exception were directors at the time of the prior amendment, have served and will continue to serve until their successors are duly elected or appointed.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a.) Exhibits

10.1 Guaranty of Affiliated Computer Services, Inc. of Citibank loan to DDH Aviation.

b.) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on the 14th day of February 2001.

AFFILIATED COMPUTER SERVICES, INC.

By: /s/ Mark A. King

Mark A. King
Executive Vice President and
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description

10.1	Guaranty of Affiliated Computer Services, Inc. of Citibank loan to DDH Aviation.